

Message Text

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PAGE 01 BRASIL 10465 222000Z
ACTION ARA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-07 FRB-03
 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03 SP-02
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R 221935Z DEC 76
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 9270
INFO AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

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E.O. 11652: N/A
TAGS: EFIN BR
SUBJECT: CRUZEIRO DEVALUATION

1. EFFECTIVE DECEMBER 22, 1976, THE CRUZEIRO WAS DEVALUED FOR THE SIXTEENTH AND PROBABLY LAST TIME THIS YEAR. WITH THE LATEST ADJUSTMENT OF 2.42 PERCENT, THE CUMULATIVE DEVALUATION IN 1976 COMES TO 36.096 PERCENT THE HIGHEST ANNUAL CHANGE SINCE THE SYSTEM MINI-DEVALUATION WAS INSTITUTED IN 1968. THE NEW RATES ARE CR\$12.275 PER US\$ FOR BUY AND 12.345 FOR SELL.

2. COMMENT: THE EFFICACY OF THE SYSTEM OF MINI-DEVALUATION IN MAINTAINING BRAZIL'S COMPETITIVE POSITION ON THE WORLD MARKET CONTINUES TO BE A SUBJECT OF DEBATE. ON THE BASIS OF THE TRADITIONAL ANALYSIS UNDERLYING THE CRAWLUNG-PEG SYSTEM I.E., THAT DE-VALUATION SHOULD REFLECT THE DIFFERENCE
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PAGE 02 BRASIL 10465 222000Z

BETWEEN THE INTERNAL AND EXTERNAL RATES OF INFLATION, THE CRUZEIRO WOULD SEEM TO HAVE LOST SOME GROUND DURING 1976. WITH AN INTERNAL RATE OF INFLATION OF 47-48 PERCENT AND AN AVERAGE INFLATION RATE IN BRAZIL'S PRINCIPAL TRADING PARTNERS OF UNDER 10

PERCENT, SUCH AN ANALYSIS WOULD INDICATE THAT THE CRUZEIRO SHOULD HAVE BEEN DEVALUED BY SOMEWHAT MORE THAN THE 36 PERCENT EXPERIENCED TO DATE. WHEN THIS POINT WAS MADE TO SIMONSEN DURING THE COURSE OF A PRIVATE MEETING, THE MINISTER REPLIED THAT, WHILE THE METHODOLOGY WAS CORRECT, THE LEVEL OF INTERNAL INFLATION WAS NOT. HE MAINTAINED THAT, IN CALCULATING THE PERIODIC CRUZEIRO ADJUSTMENTS, BRAZILIAN MONETARY AUTHORITIES DO NOT LOOK AT THE TREND OF THE GENERAL PRICE INDEX (WHICH IS NORMALLY USED TO MEASURE INFLATION IN BRAZIL) BUT AT THE PRICE INDEX OF EXPORTS OF INDUSTRIAL PRODUCTS (WHICH IS NOT PUBLISHED). HE CLAIMED THAT THE INCREASE IN THIS INDEX DURING 1976 WAS WELL BELOW THAT OF THE GENERAL PRICE INDEX BECAUSE OF THE IMPACT OF ADVERSE WEATHER CONDITIONS ON AGRICULTURAL PRICES. SIMONSEN CONCLUDED THAT ON THE BASIS OF THIS COMPARISON THE RATE OF DEVALUATION IN 1976 WAS SUFFICIENT TO MAINTAIN BRAZIL'S COMPETITIVE POSITION.

3. WE HAVE LEARNED FROM CENTRAL BANK SOURCES THAT THE IMF MISSION, WHICH WAS IN BRASILIA DURING THE FIRST WEEK OF DECEMBER, DISCUSSED AT SOME LENGTH WITH GOB OFFICIALS THE QUESTION OF THE EXCHANGE RATE. ACCORDING TO OUR SOURCE, THE IMF TEAM ARGUED FOR A SPEEDING UP OF THE RATE OF DEVALUATION IN ORDER TO IMPROVE THE GROWTH OF EXPORTS IN LIGHT OF LIMITED OFFICIAL USE

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PAGE 03 BRASIL 10465 222000Z

BRAZIL'S DEBT SERVICE BURDEN DURING THE NEXT FEW YEARS. FROM WHAT WE WERE TOLD, THE GOB WAS NOT PERSUADED BY THE IMF TEAM TO CHANGE ITS POLICY.
CRIMMINS

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